Chapter 10: Findings

10.a Return on Investment:

Since 1989, the department has purchased three categories of replacement trust lands, forest lands, agricultural lands, and commercial properties. The weighted average projected total real return on these acquisitions is 6.7 percent while the nominal return on the permanent fund since 1989 is 6.8 percent. Two adjustments are required before these two returns can be compared.

First, the total real return on the acquisition of replacement property of 6.7 percent needs to be reduced by the management fund deduction of 25 percent; this results in a net real return to beneficiaries of 5.0 percent[42].

Second, to make the nominal return to beneficiaries on the permanent fund comparable to the real return on replacement properties, the return on the permanent fund needs to be adjusted for the loss in purchasing power on the permanent fund due to inflation. The loss in purchasing power on the permanent fund since 1989 averaged 3.1 percent per year, this results in an average net real return to beneficiaries on investment in the permanent funds of 3.7 percent.

The projected real return to beneficiaries from purchase of replacement trust properties since 1989 of 5.0 percent is 32 percent greater than the comparable real return to beneficiaries from the permanent fund of 3.7 during the period.

10.b Appreciation and Long-term Revenue:

One important difference between these two alternative investments is that the beneficiary receives all of the coupon return on the permanent fund as it is earned. The real value in purchasing power terms of the corpus of the permanent fund is reduced over time by inflation, while land values increase with inflation. The appreciation in replacement land value accrues to the value of the asset and is realized by the beneficiary through higher rents and/or higher prices for the sale of the assets over time. Thus while the permanent fund may result in a higher dollar return to beneficiaries in the short run,

[42] 6.7% times (1-25%) is equal to 5.0%.

investment in replacement property is expected to result in greater long term revenues to the beneficiaries.

10.c Diversification:

Over half of the replacement property purchased has been non-forest lands. Asset value diversification has resulted in the growth of lease revenues from irrigated agriculture and commercial real estate. Revenues from irrigated agriculture leases have increased from $1.5 million in 1989 to more than $2.7 million in 2002, an 80 percent increase. Revenue from commercial real estate increased from $0.9 million in 1989 to $4.5 million in 2002, a five-fold increase. While irrigated agricultural and commercial real estate holdings represent a small percent of the land assets portfolio, these data show the positive effect of asset value diversification on sustainable revenue.

10.d Other Benefits:

In addition to providing a better return on investment, greater long-term revenue to beneficiaries, and diversification of the trust asset base, the purchase of replacement property allows the department to meet other legislative objectives given to the department. By purchasing replacement property the department is better able to maintain the publicly owned land base and the publicly owned forest land base, and to maintain the sustainable harvest of timber from department-managed lands.

By purchasing replacement trust property the department is able to provide multiple use benefits that are consistent with providing revenue to trust beneficiaries. A number of studies have shown that the social, environmental, and economic benefits from trust lands are of great value to the citizens of Washington State. Without the purchase of replacement property these benefits would diminish over time.